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SUBJECT: PANAMA: SCENESETTER FOR CODEL HAGEL, AUG. 27-28

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Summary  
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11. (SBU) You will be arriving in Panama in the middle of a long election campaign, due to take place amidst record economic growth, but growing economic uncertainty. Panama has been one of the fastest growing economies in Latin America for the last few years (11.2% growth in 2007), and there are signs of wealth throughout Panama City. But Panama is also struggling with growing inflation, especially in basic food goods, and stubbornly high poverty. Despite the problems, Panama has a promising economic future, as it gets ready to manage the huge Canal expansion project, which will cost over \$5 billion, and potentially effect global trade patterns. Amidst this economic background, the campaign for the Presidential and legislative elections, due in May 2009, is in full swing. The ruling Democratic Revolutionary Party (PRD) will hold its primary on September 7, one week after you leave. Besides the economy, crime is also increasingly an important electoral issue here, as Panamanians' fear rising crime as gang violence escalates. The government's proposed security reforms are being criticized by civil society leaders as an attempt to return to the militarism of the past. The USG and the GOP continue to cooperate very closely on a wide variety of issues, and enjoy excellent relations. President Torrijos will travel to the U.S. in mid-September to principally meet with members of Congress to push for passage of the Panama-US Free Trade bill. End Summary.

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Booming Economy, But Problems Linger  
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12. (SBU) Your visit comes at a time when Panama's economic boom contrasts starkly with sustained high levels of poverty, continuing wide income disparities, persistent corruption, and woeful educational and healthcare systems. Panama's 11.2 percent GDP growth in 2007 topped the region, driven largely by significant growth in construction, ports and maritime services, banking and financial services, and tourism. Foreign investment, which topped USD 1 billion in 2007, continues to pour into Panama, as U.S. multinationals such as Procter and Gamble, Hewlett Packard, 3M, and Caterpillar move into Panama. Occidental Petroleum and Qatar Petroleum will soon decide whether to proceed with their proposed USD 8-9 billion refinery project in the Puerto Armuelles area of western Panama, which would be a significant addition to Panama's USD 19 billion economy. With the country's strong economic growth over the past five years, Panama has cut unemployment by about half, dropping from about 14 percent in

2003 to just over 6 percent today.

¶3. (SBU) Panama also maintains one of the most liberalized trade regimes in the hemisphere. As Panama's largest trade partner (with two-way trade of USD 4.1 billion in 2007, an increase of 33 percent over 2006), the U.S. consistently runs a huge trade surplus with Panama, exporting almost ten times more than it imports. The U.S. and Panama signed a bilateral Trade Promotion Agreement (TPA) last June that the Panamanian National Assembly (NA) ratified two weeks later by an overwhelming vote. However, U.S. ratification remains on hold as a result of the NA's September 2007 election of Pedro Miguel Gonzalez, who is under federal indictment in connection with the 1992 slaying of a U.S. soldier, as its president. It now appears certain that Gonzalez will be replaced as NA President on September 1 by a little known Deputy personally chosen by President Torrijos. The GOP hopes this will help pave the way for approval of the TPA.

¶4. (SBU) Despite being one of Latin America's fastest growing economies over the past 15 years, Panama's poverty rate has persisted at nearly 40 percent overall and has exceeded 80 percent in rural indigenous areas. Torrijos hopes that sustained growth resulting from the Panama Canal expansion project and the TPA will help push Panama into "first world" status. However, neither the Canal nor the TPA is a panacea, as cronyism and weak institutions (especially the notoriously corrupt judiciary and troubled health and education sectors) have kept Panama from attaining more broadly shared prosperity.

¶5. (SBU) After some twenty years of enjoying low inflation (ranging between 1.5 and 2 percent), Panamanians now face an upward spiral in the cost of living. Annual inflation reached 4.7 percent by the end of 2007 and is now running at about 9.6 percent. Increases in the price of food have run at nearly twice the overall inflation rate. The monthly cost of a "basic basket" of foodstuffs defined by the GOP as the minimal amount needed by a typical Panamanian has skyrocketed by more than 20 percent over the past year, reaching nearly USD 250 per month. This means that workers earning the minimum monthly wage of USD 310 must spend more than 80 percent of their income on food, while those earning the average wage of USD 400 spend more than 60 percent of their earnings just to buy the basic food items. This, combined with fast-rising electricity and gasoline prices, has tightened the squeeze on low and middle-income families.

¶6. (SBU) Despite spending about 12 percent of the GOP's budget on education, Panama suffers from a poorly educated workforce. About half of prospective University of Panama students fail their entrance exams, prompting university authorities to lower the threshold for entrance. About one-third of the applicants to GOP worker training programs are rejected because they lack the requisite literacy and math skills. Panamanian and multi-national firms must draw from a labor pool that is poorly equipped to compete in the global economy. One U.S. multi-national found that less than 1 percent of some 200 prospective Panamanian employees passed the firm's qualifying examination. By comparison, the firm found that pass rates elsewhere in the region typically ranged from 15 to 20 percent. This dynamic is exacerbated by laws that require foreign firms to staff 90 percent of their local operations with Panamanian employees

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Panama Canal Expansion Underway  
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¶7. (U) In September 2007, the Panama Canal Authority (ACP) formally launched its eight-year, USD 5.25 billion program to expand and modernize the Panama Canal. This project is due for completion in 2014. The ACP plans to finance the project through a combination of Canal revenues, increased tolls, and USD 2.3 billion in bridge loans. U.S.-based engineering and law firms have won initial contracts to provide project management and legal advisory services to the ACP. Four consortia, one led by Bechtel, are preparing to bid in late

2008 on the design/build contract for the new, much larger sets of locks that will be built in parallel to the existing locks. With an estimated contract value of about USD 3.5 billion, this represents the largest share of expansion-related work. The winning consortium will have to contend with the upward spiral in fuel and construction materials costs, Panama's shallow pool of skilled labor, and constraints on housing, transportation, and other infrastructure.

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Panama's Politicos Jockey for 2009 Elections  
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¶8. (SBU) Ten months from the end of his five-year term, President Torrijos has seen his public approval rating erode considerably, declining, according to some polls, by as much as 60 percent. His Revolutionary Democratic Party (PRD) dominates Panama's unicameral National Assembly and other governmental institutions. Torrijos is constitutionally prohibited from a consecutive term, and his former Housing Minister and long-time PRD figure, Balbina Herrera, looks likely to win the PRD primaries, which will take place on September 7, over Panama City mayor Juan Carlos Navarro. Opposition parties seem to be forming into two rival blocks, and a grand alliance does not look likely unless one of the two sides begins to poll very poorly. One of the two blocks is forming around the Panamenista Party, the largest opposition party, that elected Juan Carlos Valera as its Presidential candidate in primary elections on June 6. He has since risen substantially in the polls, making a grand alliance between the Panamenista party and the other major opposition block less likely. The other main opposition block is led by maverick Ricardo Martinelli of Democratic Change (CD), which recently formed an alliance that gives this block a roughly equal number of loyalist as the Panamenistas.

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Security Issues Come to the Fore  
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¶9. (SBU) Over the past eight months, security concerns have become one of the top issues on the minds of Panamanian voters. Panama experienced a significant up-tick in crime, not only in Panama City but also across the country, leading to an increasing clamor that the GOP do something to improve law and order. The increase in crime seems to be tied to increased drug dealing within Panama. Continued record seizures of illegal narcotics in Panama serve to underscore that Panama remains a cross roads for illicit trade. For example, of the 120 metric tons of cocaine seized by authorities in the hemisphere during 2007. So far in 2008, law enforcement authorities have seized some 30 metric tons of cocaine.

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Torrijos' Legislative Powers on Security Matters  
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¶10. (SBU) Before going into recess on June 30, the NA granted Torrijos extraordinary powers to enact legislation from that date until the NA reconvened on September 1. The GOP in planning to use those powers to enact legislation which would: establish the National Aero-Naval Service (SENAN) by combining Panama's air and sea forces; establish the National Frontier Service (SENAFRONT) by breaking an existing force off from the Panamanian National Police (PNP); establish the National Intelligence and Security Service (SENIS) by breaking an existing organization off from the Council for Public Security and National Defense (CSPDN); reorganize the CSPDN into a Panamanian version of the NSC; and enable the President to name a uniformed officer to head the PNP and the Institutional Protection Service (Panama's Secrete Service), where present law requires that both posts be held by civilians. Numerous government officials have indicated that the GOP sees these reforms as necessary to prepare Panama for the potential increase in criminal activity in Panama by international criminal networks as a

result of the Colombian government's offensive against the FARC, and the likely effects of the Merida Initiative in Mexico.

¶11. (SBU) These proposed reforms have been strongly criticized by civil society leaders and the local press as potentially opening the door to a return to militarism. Many commentators have tried to find a connection between these proposed reforms and the Merida Initiative, and some have accused the USG of trying to re-militarize Panama. The matter of the security reforms will likely come to a head in the next two weeks, as President Torrijos is likely to act before his special powers expire. The opposition effort to stop this may have crested by then, but the issue is likely to become a political issue during the elections.

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Panama at the UN Security Council  
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¶12. (SBU) In late 2006, Panama emerged as Latin America's consensus candidate for a two-year seat on the UN Security Council (UNSC). This followed a prolonged deadlock between Venezuela and Guatemala in the voting for non-permanent members in the UN General Assembly. Panama has consistently voted with the U.S. and has played a constructive role on the UNSC. In other foreign policy matters, Torrijos has pursued a policy of maintaining friendly relations with all countries that seek friendly relations with Panama, including Cuba and Venezuela.

STEPHENSON